Supreme Court, U.S.
FILED
JUN 2 6 2003
OFFICE OF THE CLERK

No. 02-1196

IN THE SUPREME COURT OF THE UNITED STATES

SECURITIES AND EXCHANGE COMMISSION,

Petitioner,

v.

CHARLES E. EDWARDS,

Respondent.

On Writ of Certiorari to The United States Court of Appeals for the Eleventh Circuit

BRIEF *AMICUS CURIAE* OF AARP IN SUPPORT OF PETITIONER

STACY CANAN *
DEBORAH M. ZUCKERMAN
AARP FOUNDATION

MICHAEL R. SCHUSTER
AARP

601 E Street, NW
Washington, DC 20049
(202) 434-2060

Counsel for AARP

***Counsel of Record**

20 pp

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ii

INTEREST OF *AMICUS CURIAE* 1

SUMMARY OF ARGUMENT 2

ARGUMENT 4

I. FEDERAL SECURITIES' LAWS SHOULD BE BROADLY CONSTRUED IN ORDER TO EFFECTUATE THEIR REMEDIAL PURPOSES . 4

II. COURTS MUST LOOK AT THE SUBSTANCE NOT THE FORM OF A TRANSACTION WHEN DETERMINING WHETHER FRAUDULENT CONDUCT IS COVERED UNDER FEDERAL SECURITIES' LAWS 5

A. When Looking at the Substance of ETS'Payphone Leaseback Investment Scheme, It Is Evident That It Is an "Investment Contract" under the Federal Securities' Laws 6

III. OLDER INVESTORS ARE FREQUENT TARGETS OF FRAUD AND THUS NEED ANTI-FRAUD PROTECTIONS MAINTAINED UNDER THE SECURITIES' LAWS 7

A. Securities Fraud Is a Pervasive Problem ... 8

B. Individuals Are Investing in the Securities Markets in Unprecedented Numbers, Often for the First Time 10

C. Individual Investors Have Extremely Low Levels of "Financial Literacy" Making Them Susceptible to Fraud 11

CONCLUSION 13

TABLE OF AUTHORITIES

CASES **Pages**

In re PaineWebber Ltd. Partnership Litigation, 171 F.R.D. 104 (S.D.N.Y. 1997) 9

In re Prudential Sec. Inc. Ltd. Partnership Litigation, 163 F.R.D. 200 (S.D.N.Y. 1995) 9

Reves v. Ernst & Young, 494 U.S. 56 (1990) 2-4

SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344 (1943) .. 5

SEC v. ETS Payphones Inc., et al., 123 F. Supp. 2d 1349 (N.D. GA 2000) 7

SEC v. Infinity Group Co., 212 F.3d 180 (3d Cir. 2000), *cert. denied*, 532 U.S. 905 (2001) 5

SEC v. United Benefit Life Insurance Co., 387 U.S. 202 (1967) 5

SEC v. W.J. Howey Co., 328 U.S. 293 (1946) 5, 6

SEC v. Zandford, 535 U.S. 813 (2002) 2, 4

United States v. Carman, 577 F.2d 556 (9th Cir. 1978) ... 5

FEDERAL STATUTES

Securities Act of 1933,
15 U.S.C. § 77a *et seq.* 2
15 U.S.C. § 77b(a)(1) 4, 6
15 U.S.C. § 77q 8

Securities Exchange Act of 1934,
15 U.S.C. § 78a *et seq.* 2
15 U.S.C. § 78c(a)(10) 4, 6
15 U.S.C. § 78 (j) 8

MISCELLANEOUS

AARP, PPI, Beyond 50: A Report to the Nation on Economic Security (Apr. 2003), *available at* http://research.aarp.org/general/beyond_50.htm 10

AARP, Investor Awareness of Broker Compensation Practices: Findings From an AARP Survey (Apr. 1998) 12

AARP, Investor Understanding of Broker Account Statements: Findings From a Survey (Oct. 2000), *available at* http://research.aarp.org/consumer/broker.pdf. 12

Coming to Terms, CSFB Agrees to Pay $100 Million to Settle Twin IPO Investigations, Wall St. J., Dec. 11, 2001 9

Carolyn L. Dessin, Financial Abuse of the Elderly, 36 Idaho L. Rev. 203 (2000) 7

Friedman, *Confidence Swindles of Older Consumers*, 26 J.Consumer Aff. 20 (1992) 7

Sarah Holden & Jack VanDerhei1, *Can 401(k) Accumulations Generate Significant Income for Future Retirees?*, Investment Company Institute Perspective, Vol. 8 / No. 3, (Nov. 2002), *available at* http://www.ici.org/ici_frameset.html. 10

Investment Company Institute, Frequently Asked Questions About Mutual Fund Shareholders (Oct. 2002), *at* http://www.ici.org/ici_frameset.html 13

Investment Company Institute, Household Ownership of Mutual Funds in 2002, ICI Research in Brief, Vol. 11 / No. 5 (October 2002), *available at* http://www.ici.org/ici_frameset.html. 11

Investment Company Institute, Mutual Funds and the U.S. Retirement Market in 2001, Fundamentals, Research in Brief, Vol. 11 / No. 2, (June 2002), *available at* http://www.ici.org/ici_frameset.html. 11

Investment Company Institute, Trends in Mutual Fund Investing (April 2003), *available at* http://www.ici.org/ici_frameset.html. 11

North American Securities Administrators Association, Press Release, Beware of Oil and Gas Schemes (Mar. 6, 2003), *available at* http://www.nasaa.org/nasaa/scripts/prel_display.asp?rcid=193 9

North American Securities Administrators Association, Investor Tips, How Older Americans Can Avoid Investment Fraud and Abuse (June 22, 2003), *at* http://www.nasaa.org/nasaa/scripts/tx_display.asp?rcid=29 7

North American Securities Administrators Association Press Release, Putting Investors First: A Legislative Agenda for 2003 (Dec.23, 2002), *available at* http://www.nasaa.org/nasaa/scripts/prel_display.asp?rcid=190 10

North American Securities Administrators Association, Press Release, Securities Regulators Unveil Fraud Awareness Quiz (April 30, 2003), *available at* http://www.nasaa.org/nasaa/scripts/prel_display.asp?rcid=199 8

North American Securities Administrators Association, Press Release, error Fears Exploited (Mar. 18, 2003), *available at* http://www.nasaa.org/nasaa/scripts/prel_display.asp?rcid=195 9

North American Securities Administrators Association, Press Release, Top 10 Investment Scams (Apr. 23, 2003), *available at* http://www.nasaa.org/nasaa/scripts/prel_displayasp?r.cid=153 9

North American Securities Administrators Association, Securities and Exchange Commission, New York Attorney General, National Association of Securities Dealers, and New York Stock Exchange, Press Release, Ten of Nation's Top Investment Firms Settle Enforcement Actions Involving Conflicts of Interest Between Research and Investment Banking (April 28, 2003), *available at* http://www.nasaa.org/nasaa/Files/File_Uploads/Press%20release%20for%20posting. 37737-80425.pdf 8

SEC, Office of Investor Education and Assistance, The Facts on Saving and Investing 2 (Apr. 1999) 13

SEC, Report of the Securities and Exchange Commission: Section 703 of Sarbanes-Oxley Act of 2002, Study and Report on Violations by Securities Professionals (Jan. 24, 2003), *available at* http://www.sec.gov/news/studies/sox703report.pdf 8

Securities Investor Protection Corporation & National Association of Investors Corporation, Press Release, Survey: More Than 4 Out of 5 U.S. Investors Fail Quiz of Basic "Survival" Knowledge (Aug. 1, 2001), *available at* http://216.181.142.217/sipc/release0.html. 12

Ruth Simon, *We Put Investors to the Test -- and, Boy, Did They Ever Flunk*, Money, Mar. 1998 12

Richard A. Starnes, Note, *Consumer Fraud and the Elderly: The Need for A Uniform System of Enforcement and Increased Civil and Criminal Penalties*, 4 Elder L.J. 201(1996) 7

Towers Perrin, Preparing for Retirement: A Survey of 1,000 Working Americans (Feb. 1995) 12

United States Postal Inspection Service, Investment Fraud Schemes, *at* http://www.usps.com/postalinspectors/invest.htm (last visited June 24, 2003) 8

No. 02-1196

IN THE
SUPREME COURT OF THE UNITED STATES

SECURITIES AND EXCHANGE COMMISSION,

Petitioner,

v.

CHARLES E. EDWARDS,

Respondent.

On Writ of Certiorari to the
United States Court of Appeals
For the Eleventh Circuit

BRIEF *AMICUS CURIAE* OF AARP IN SUPPORT OF PETITIONER

INTEREST OF *AMICUS CURIAE*[1/]

AARP is a nonpartisan, nonprofit organization with 35 million members, dedicated to addressing the needs and interests of Americans age 50 and older. As the largest membership organization representing the interests of older Americans, AARP is greatly concerned about the rampant deception, fraud, and unfair practices perpetrated upon consumers in a broad range of transactions since older Americans are disproportionately victimized by such practices. For example, older Americans are frequent targets of investment fraud because they often have significant assets and

---

[1/] Letters of consent from both parties have been filed with the Clerk. No counsel for a party authored this brief in whole or in part, and no person or entity other than amicus curiae or its counsel made a monetary contribution to the preparation and submission of this brief.

are looking for investment opportunities that will supplement their Social Security and pension benefits received during retirement.

AARP thus supports laws and public policies that will protect older persons and preserve the legal means for redress when they are harmed in the marketplace. In the investment area, AARP has commented on legislative and regulatory proposals that address fraudulent and deceptive conduct, filed briefs as *amicus curiae* in cases involving interpretation of the federal securities' laws, e.g., *SEC v. Zandford,* 535 U.S. 813 (2002), and opposed efforts to limit federal statutory remedies that allow defrauded investors to obtain financial redress. In addition, AARP has undertaken efforts to educate investors about how to choose financial professionals who will act in their best financial interest.

AARP believes that the interpretation of the securities' laws adopted by the decision below improperly undermines the ability of those victimized by fraud to obtain recovery for their injuries, contrary to both the language and the policies of federal securities' laws. AARP, therefore, is concerned that if the Eleventh Circuit's decision is affirmed, enforcement of and protections currently afforded investors under the Securities Act of 1933, 15 U.S.C. § 77a *et seq.* and the Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.* will be diminished.

SUMMARY OF ARGUMENT

The Eleventh Circuit erred when holding that Respondent's payphone leaseback investment scheme was not an "investment contract" covered under the federal securities' laws. The court's ruling that "investment contracts" do not exist where the promised return on an investment is fixed rather than variable unduly restricts the definition of "investment contract." The federal securities' laws are construed flexibly in order to effectuate the laws' remedial purposes. *SEC v. Zandford*, 535 U.S. 813, 819 (2002). Congress enacted the securities' laws "to regulate investments, in whatever form they are made and by whatever name they are

called."*Reves* v. *Ernst & Young*, 494 U.S. 56, 61 (1990). In order to achieve its goal to protect investors, Congress defined 'security' broadly to "encompass virtually any instrument that might be sold as an investment." *Id.* By excluding investments with fixed or contractually promised returns from the definition of "investment contract," the court of appeals failed to apply a flexible interpretation, thereby allowing perpetrators of fraud an avenue in which they can operate while evading the law. Undoubtedly, fraud perpetrators, in order to evade the law, will quickly learn to adjust their tactics by promising a fixed rate of return on a purported investment. If this sort of loop hole in the federal securities' laws is allowed to become the law of the land and fraudsters begin to evade the laws with impunity, there will be dire consequences for the older and less sophisticated investor who are the most frequent targets of fraudulent investment schemes.

In recent years, Americans have entered our nation's securities markets in record numbers, many for the first time. This is due, in large part, to the recognition that individuals have to plan and provide for their retirement security with less reliance on Social Security and traditional employer-sponsored defined benefit pension plans. Also, due to the volatility of U.S. markets, older Americans dependent on predictable interest income are looking for safe havens and therefore are susceptible to scams that offer investments with purported low risks and high returns.

As the number of investors has increased, so has the incidence of investment fraud and unfair practices. As in the instant case, investment fraud is not limited to the sale of traditional securities such as stocks and bonds. Unfortunately, many older first time investors lack the basic skills and necessary information to manage and oversee their investments, making them even more vulnerable to fraudsters. As a result, unsophisticated investors often misplace their trust in individuals who are not acting in the investor's best interest or are even engaging in an outright fraudulent scheme. After unwittingly placing their retirement nest egg in jeopardy, older investors too often tragically lose their life savings, at a time in their lives when it is needed the most. Our vulnerable

investors, therefore, need greater protection from fraudsters, not less.

Unless the Court reverses the Eleventh Circuit and upholds the standard intended by Congress and advanced by Petitioner, essential legal protections intended to benefit investors will be eroded, and America's individual investors and their financial futures will remain at the mercy of unscrupulous practitioners.

ARGUMENT

I. FEDERAL SECURITIES' LAWS SHOULD BE BROADLY CONSTRUED IN ORDER TO EFFECTUATE THEIR REMEDIAL PURPOSES.

The Eleventh Circuit erred when holding that Respondent's payphone leaseback investment scheme was not an "investment contract" covered under the federal securities' laws. The court's ruling that "investment contracts" do not exist where the promised return on an investment is fixed rather than variable unduly restricts the definition of "investment contract." The court of appeals' decision, thereby, undermines Congress' goal to enact flexible securities' laws in order to protect vulnerable investors from varied investment scams and deceitful advisors and brokers.

The federal securities' laws are construed flexibly in order to effectuate the laws' remedial purposes. *SEC v. Zandford*, 535 U.S. 813, 819 (2002). Congress enacted the securities' laws "to regulate investments, in whatever form they are made and by whatever name they are called." *Reves v. Ernst & Young*, 494 U.S. 56, 61 (1990). In order to achieve its goal to protect investors, Congress defined "'security' broadly to encompass virtually any instrument that might be sold as an investment." *Id.* Thus, Congress included in the definition of "security" in Section 2(a)(1) of the Securities Act of 1933 (Securities Act), 15 U.S.C. 77b(a)(1), and Section 3(a)(10) of the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. 78c(a)(10), the term "investment contracts," in

addition to conventional securities, such as stocks and bonds.[2/] An investment contract is "a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." *SEC v. W.J. Howey Co.*, 328 U.S. 293, 299 (1946). As such, investment contracts include "[n]ovel, uncommon, or irregular" investment products. *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 351 (1943). *See also SEC v. United Benefit Life Insurance Co.*, 387 U.S. 202, 211(1967) (holding that annuities that promised financial "'growth' through sound investment management" were investment contracts); *SEC v. Infinity Group Co.*, 212 F.3d 180 (3d Cir. 2000), *cert. denied*, 532 U.S. 905 (2001) (holding that the promise of a fixed return for transferring money to a trust was an investment contract); *United States v. Carman*, 577 F.2d 556 (9th Cir. 1978) (holding that sale of a student promissory note with a fixed return was an investment contract).[3/]

II. COURTS MUST LOOK AT THE SUBSTANCE NOT THE FORM OF A TRANSACTION WHEN DETERMINING WHETHER FRAUDULENT CONDUCT IS COVERED UNDER FEDERAL SECURITIES' LAWS.

To effectuate Congressional intent, courts must look at the substance not the form of a transaction when determining whether fraudulent conduct is covered under the securities' laws. *Howey*, 328 U.S. at 298, 301 (holding that the statutory policy of affording broad protection to investors is not to be thwarted by unrealistic and irrelevant formulae). To allow the Eleventh Circuit's decision to stand, therefore, would be in contravention of Congress' intent that the definition of

---

[2/] An "investment contract" is "a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party." *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298-299 (1946).

[3/] The court of appeals' decision also conflicts with the Securities Exchange Commission's (SEC's) formal adjudicatory opinions. *See*, SEC Pet. at 23-24.

securities must be sufficiently flexible so that the laws protect investors from the countless and constantly changing schemes devised by fraud perpetrators. *Howey*, 328 U.S. at 299.

By excluding investments with fixed or contractually promised returns from the definition of "investment contract," the court of appeals' decision will allow perpetrators of fraud an avenue in which they can operate while evading Securities' laws. Fraud perpetrators will quickly learn to evade securities' laws by promising a fixed rate of return on a purported investment. If this sort of loop hole in the federal securities' laws is allowed to become the law of the land and fraudsters begin to evade these laws with impunity, there will be dire consequences for the older and less sophisticated investors who are the most frequent targets of fraudulent investment schemes.

A. When Looking At the Substance of ETS' Payphone Leaseback Investment Scheme, It Is Evident That It Is an "Investment Contract" under the Federal Securities' Laws.

When looking at the substance, as opposed to the form, of the transaction in dispute here, Respondent's nationwide payphone leaseback investment scheme falls within the definition of an "investment contract" under the federal securities' laws. Section 2(a)(1) of the Securities Act, 15 U.S.C. § 77b(a)(1), and Section 3(a)(10) of the Securities Exchange Act, 15 U.S.C. § 78c(a)(10). The SEC charged that Respondent, Charles E. Edwards, through its company ETS Payphones (ETS), fraudulently sold to mostly elderly, inexperienced investors in thirty-eight states coin-operated telephones that carried lease back agreements to ETS. ETS, acting through distributors, who were primarily licensed insurance agents, and other advertisement avenues such as the Internet and mailed brochures, sold the leased back phones by promising profits as high as a fixed 14.1 percent annual rate of return.

Unfortunately for investors, the Respondent's promises of profits were false and most of Respondent's investors lost

their entire investment. The district court found that Respondent's "actions were egregious in operating an investment scheme at a significant loss while only [Respondent] profited." *SEC v. ETS Payphones Inc., et al.*, 123 F. Supp. 2d 1349, 1355 (N.D. GA 2000). The district court found that ETS continued to advertise that the leaseback payphones were a very profitable investment while at the same time ETS was losing millions of dollars. For example, from November 1998 to March 1999, ETS had an operating loss of $32 million and therefore the company had to attract an ever expanding number of investors to meet its obligations to existing investors. Moreover, notwithstanding the company's enormous undisclosed losses, ETS paid Respondent Edwards $2.24 million in compensation and made $11.6 million in interest free loans to companies controlled by Edwards. *Id.* at 1352.

III. OLDER INVESTORS ARE FREQUENT TARGETS OF FRAUD AND THUS NEED ANTI-FRAUD PROTECTIONS MAINTAINED UNDER THE SECURITIES' LAWS.

Older Americans are disproportionately likely to be victimized by fraud as compared to younger people. *See* Friedman, *Confidence Swindles of Older Consumers*, 26 J.Consumer Aff. 20 (1992); Richard A. Starnes, Note, *Consumer Fraud and the Elderly: The Need for A Uniform System of Enforcement and Increased Civil and Criminal Penalties*, 4 Elder L.J. 201(1996) (citing studies). Frauds perpetrated against older people cause especially devastating consequences since the "likelihood that an elder person's income is fixed may make it extremely difficult to recover from a financial loss." Carolyn L. Dessin, *Financial Abuse of the Elderly*, 36 Idaho L. Rev. 203, 205 (2000).

Older Americans are the primary targets of investment con artists. Additionally, stockbrokers and financial planners who engage in abusive practices often seek out the elderly. North American Securities Administrators Association (NASAA), Investor Tips, How Older Americans Can Avoid Investment Fraud and Abuse (June 22, 2003), *at*

http://www.nasaa.org/nasaa/scripts/tx_display.asp?rcid=29. *See also* United States Postal Inspection Service, Investment Fraud Schemes, *at* http://www.usps.com/postalinspectors/invest.htm (last visited June 24, 2003).

A. Securities Fraud Is a Pervasive Problem.

State regulators estimate that securities fraud costs Americans billions of dollars each year. Press Release, NASAA, Securities Regulators Unveil Fraud Awareness Quiz (April 30, 2003), *available at* http://www.nasaa.org/nasaa/scripts/prel_display.asp?rcid=199. Indeed, securities fraud and unfair practices continue to present a pervasive problem for American investors. *See, e.g.*, Press Release, NASAA, Securities and Exchange Commission (SEC), N.Y. Attorney Gen., Nat'l Assoc. of Securities Dealers, and N.Y. Stock Exch., Ten of Nation's Top Investment Firms Settle Enforcement Actions Involving Conflicts of Interest Between Research and Investment Banking (April 28, 2003), *available at* http://www.nasaa.org/nasaa/Files/File_Uploads/Press%20release%20for%20posting.37737-80425.pdf (announcing global settlement of enforcement actions against ten of the nation's top investment firms, which were charged with conflicts of interest, requiring the firms to pay penalties of $487.5 million, disgorgement of $387.5 million, payments of $432.5 million to fund independent research, and payments of $80 million to fund investor education); SEC, Report of the Securities and Exchange Commission: Section 703 of Sarbanes-Oxley Act of 2002, Study and Report on Violations by Securities Professionals (Jan. 24, 2003), *available at* http://www.sec.gov/news/studies/sox703report.pdf(finding that securities professionals who violated securities' laws from 1998 - 2001 most frequently violated the anti-fraud provisions: Section 10(b) of the Exchange Act of 1934, 15 U.S.C. § 78(j) and Section 17(a) of the Securities Act of 1933, 15 U.S.C. § 77(q)).

Investment fraud is not limited to the sale of traditional securities such as stocks and bonds. "Our volatile markets have investors, particularly older Americans dependent on predictable interest income, looking for safe havens. So scammers are pitching their investments as low risk and high

return," according to Deborah Bortner, president of the North American Securities Administrators Association (NASAA) and Washington State's director of securities. Press Release, NASAA, Top 10 Investment Scams (Apr. 23, 2003), *available at* http://www.nasaa.org/nasaa /scripts/prel_displayasp?r.cid =153.[4/] For example, major brokerage houses peddled high risk limited partnerships, falsely touting their suitability for conservative and older investors. *Coming to Terms, CSFB Agrees to Pay $100 Million to Settle Twin IPO Investigations,* Wall St. J., Dec. 11, 2001, at A1 (SEC announcing Credit Suisse First Boston will pay $100 million to resolve federal investigation into alleged abuses in distribution of its IPOs). *See also* Press Release, NASAA, Terror Fears Exploited (Mar. 18, 2003), *available at* http://www.nasaa.org/nasaa/scripts/prel_display.asp?rcid=195 (warning that in the wake of the September 11, 2001 attacks, con artists were promoting investments in bogus companies touting anthrax detectors and "revolutionary" security-enhancing technologies); Press Release, NASAA, Beware of Oil and Gas Schemes (Mar. 6, 2003), *available at* http://www.nasaa.org/nasaa/scripts/prel_display.asp?rcid=193 (warning that con-artists seeking to exploit fears over Mideast conflicts were promoting fraudulent oil investments); *In re Prudential Sec. Inc. Ltd. P'ship Litig.*, 163 F.R.D. 200 (S.D.N.Y. 1995) (describing $110 million settlement with an investor class growing out of Prudential's fraudulent marketing of 700 limited partnership units); *In re PaineWebber Ltd. P'ship Litig.*, 171 F.R.D. 104, 106 (S.D.N.Y. 1997) (approving $200 million settlement in action growing out of limited partnership sales).

[4/] Included among the "Top Ten Investment Scams" listed by State Securities Regulators were (1) unlicenced individuals, such as life insurance agents, selling securities; (2) affinity group fraud where scammers use their victim's religious or ethnic identity to gain their trust; (3) payphone and ATM type sales; (4) promissory notes issued by little-known or sometimes non-existent companies that promise high returns and little or no risk; (5) ponzi/pyramid schemes where scammers promise high returns to investors, but the only people who consistently make money are the promoters; (6) callable CDs sold to elderly investors, which do not mature for 10- to 20 -years, unless the bank, not the investor, "calls," or redeems, them; (7) viatical settlements purporting to sell interests in the death benefits of terminally ill patients; and (8) prime bank schemes where scammers promise investors triple-digit returns through access to the investment portfolios of the world's elite banks. *Id.*

B. Individuals Are Investing in the Securities Markets in Unprecedented Numbers, Often For the First Time.

Americans have departed, in unprecedented numbers, from placing primary reliance on federally-insured products, such as savings accounts and certificates of deposit, for their retirement needs. "The past two decades have brought enormous change to Wall Street and all our financial markets. We're now a nation of investors, 84 million strong; half of all U.S. households own stocks or mutual funds. Americans are relying on securities products and our securities markets to create the wealth they will need for retirement...." Press Release, NASAA, Putting Investors First: A Legislative Agenda for 2003 (Dec.23,2002), *available at* http://www.nasaa.org/nasaa/scripts/prel_display.asp?rcid=190.

Americans are investing in greater numbers in large part because individuals have to plan and provide for their retirement security with less reliance on Social Security and traditional employer-sponsored defined benefit pension plans. Social Security is expected to provide proportionately less of a retiree's needed retirement income. AARP, PPI, Beyond 50: A Report to the Nation on Economic Security (Apr. 2003), *available at* http://research.aarp.org/general/beyond_50.htm. For example, in a recent study, 401(k) accumulations are projected to generate income to replace at least 51 percent of pre-retirement income for half of retirees in the lowest income quartile and at least 69 percent for half of those in the highest income quartile. Sarah Holden & Jack VanDerhei1, *Can 401(k) Accumulations Generate Significant Income for Future Retirees?*, Investment Company Institute Perspective, Vol. 8 / No. 3, (Nov. 2002), *available at* http://www.ici.org/ici_frameset.html.

Accordingly, assets[5/] in the U.S. retirement market rose to $10.9 trillion at year-end 2001 according to the Investment

[5/] Retirement assets include individual retirement accounts, annuities, and employer-sponsored defined benefit and defined contribution pension plans.

Company Institute ("ICI").[6/] ICI, Mutual Funds and the U.S. Retirement Market in 2001, Fundamentals, Research in Brief, Vol. 11 / No. 2, (June 2002), *available at* http://www.ici.org/ici_frameset.html. *See also* ICI, U.S. Household Ownership of Mutual Funds in 2002, ICI Research in Brief, Vol. 11/ No. 5 (October 2002), *available at* http://www.ici.org/ici_frameset.html (reporting that an estimated 54.2 million U.S. households owned mutual funds in May 2002,[7/] representing 49.6 percent of all U.S. household compared with 5.7% in 1980).

The potential for fraud and other abuses significantly increases as large numbers of first-time investors enter the securities markets and, due to their relative lack of sophistication and high financial illiteracy, rely on a range of planners and sales agents for investment advice.

C. Individual Investors Have Extremely Low Levels of "Financial Literacy" Making Them Susceptible to Fraud

Several studies conducted by government agencies, financial services corporations, and non-profit organizations have found that individual investors lack even the most rudimentary knowledge needed to make informed investment decisions. Investors do not know the basics of how investments work, and they do not even know what they are doing with their own money. The Securities Investor Protection Corporation and the National Association of Investors Corporation recently reported that 85% of American

[6/] The Investment Company Institute is the national association of the American investment company industry. Founded in 1940, its membership includes 8,710 mutual funds, 481 closed-end funds, and 7 sponsors of unit investment trusts.

[7/] This number reflects a decrease from a revised 56.3 million in May 2001 due to a market downturn. *Id.* However, the combined assets of the nation's mutual funds increased by $220 billion, or 3.5 percent, to $6.485 trillion from March to April 2003, according to the Investment Company Institute's official survey of the mutual fund industry. ICI, Trends In Mutual Fund Investing (April 2003), *available at* http://www.ici.org/ici_frameset.html.

investors do not know enough to pass a "survival" quiz designed to assess their knowledge of what to do in times of market downturns and other financial difficulties. For example, almost two in three investors do not know the first step to take when they suspect they are dealing with a problem broker, and fewer than one in five knows there is no insurance for stock market losses. Press Release, Securities Investor Protection Corp. & Nat'l Assoc. of Investors Corp., Survey: More Than 4 Out of 5 U.S. Investors Fail Quiz of Basic "Survival" Knowledge (Aug. 1, 2001), *available at* http://216.181.142.217/sipc/release0.html. *See also* Ruth Simon, *We Put Investors to the Test -- and, Boy, Did They Ever Flunk*, Money, Mar. 1998, at 37 (reporting on results of MONEY/Vanguard Mutual Fund Literacy Test where mutual fund investors scored an average of just 51 out of 100); Towers Perrin, Preparing for Retirement: A Survey of 1,000 Working Americans 9 (Feb. 1995) (reporting that one-third of 401(k) or other retirement savings plan investors think there is no risk associated with bonds, and 14% think there is no risk associated with "mutual fund" or "balanced" fund investments) (reports on file with AARP).

An AARP survey revealed that experienced investors with full-service brokerage accounts do not understand much of the information on typical account statements, including basic terms such as "equity," or fundamental transactions, such as the number of shares reinvested in a particular fund to determine investor awareness of broker compensation practices. AARP, Investor Understanding of Broker Account Statements: Findings From a Survey 5-6 (Oct. 2000), *available at* http://research.aarp.org/consume/broker.pdf. Another AARP survey of people 50 and older confirmed that investors are unaware of the conflicts of interest that may arise because of practices, such as sales contests and higher commissions for the sale of proprietary products. AARP, Investor Awareness of Broker Compensation Practices: Findings From an AARP Survey 3-4 (Apr. 1998) (on file with AARP).

Alarmingly, these findings show that individual investors are not adequately equipped to oversee their

investments. "America faces a financial literacy crisis. At a time when more Americans than ever before are investing in our securities markets through the purchase and sale of stocks, bonds, and mutual funds, numerous studies show they lack the financial basics." SEC, Office of Investor Education and Assistance, The Facts on Saving and Investing 2 (Apr. 1999) (on file with AARP). Lacking basic knowledge of how the securities markets operate, and being unaware of the fundamental features of their own investments, individual investors rely in large measure on third parties for advice on the purchase and sale of securities. More than 80% of new mutual fund purchases were made through intermediaries such as brokers, banks, financial planners, insurance agents, and employers,[8/] and 37% of shareholders purchase funds primarily through full-service brokers, insurance agents, financial planners, or bank representatives. ICI, Frequently Asked Questions About Mutual Fund Shareholders (Oct. 2002), *at* http://www.ici.org/ici_frameset.html. In spite of this, almost four-fifths (79%) of investors feel it is difficult to know how to choose a good professional investment advisor. SEC, The Facts on Saving and Investing, *supra*, at 24.

Individual investors' lack of knowledge about the securities markets, their own investments, and how to choose trustworthy financial professionals place these investors at great risk of being defrauded by unscrupulous practitioners.

[8/] Nearly half (48%) of mutual fund shareholders identified an employer-sponsored retirement plan as their primary method for purchasing mutual funds, and 57% bought their first fund through these plans. ICI, Frequently Asked Questions About Mutual Fund Shareholders (Oct. 2002), *at* http://www.ici.org/ici_frameset.html.

CONCLUSION

For the foregoing reasons, AARP requests that the Court reverse the Eleventh Circuit's ruling in this case.

June 26, 2003

Respectfully submitted,

Stacy Canan*
Deborah Zuckerman
AARP Foundation

Michael Schuster
AARP

Counsel for AARP
601 E Street, NW
Washington, DC 20049
(202) 434-2060

*Counsel of Record